D.C.R.B. REPORT

A Publication of the D.C. Retirement Board
for Active and Retired Fire Fighters, Police Officers, and Teachers

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D.C. Retirement Board

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The Chairman's Corner

Unless you have avoided all media coverage of the financial markets in the last two years, you already know about the considerable amount of volatility, negative momentum and other commentaries of the longest bear market since the oil crisis in the early 1970s. The good news is your Retirement Board has a sound, diversified long-term investment strategy that is equipped to hedge against market turbulence and exploit opportunities in good times, ultimately protecting your retirement income for a safe and sound future. For those highly publicized corporate scandals involving violations of Federal securities laws, the Board has retained two highly experienced securities litigation firms to assist with claims and recoveries to further protect the corpus of the Retirement Funds managed by the Board. You can read more about the Board's investment program on page 2 in this edition of the DCRB Report.

In previous editions, we have reported on progress made on the joint project between the Board and the U.S. Department of the Treasury (U.S. Treasury) on revisions to retirement plan description summaries (Summary Plan Descriptions or SPDs) for the District's police officers, fire fighters and teachers. According to sources at U.S. Treasury, all work (content and format) is now complete and the final SPDs are expected to be available for distribution in late October 2002.

On the legislative front, several measures have been approved by the City Council that, among other things, facilitate the transfer or rollover of distributions from one type of retirement plan to another. I invite you to read the Legislative Report in this edition for further updates.

Several changes have occurred among Board members and staff since our last DCRB Report. Mayoral appointee William H. Simons, retired DCPS teacher and former President of the Washington Teachers Union, was reappointed to serve an additional four-year term. During his extended term, Mr. Simons has agreed to employ his considerable skills as Chairman of the Board's Legislative Committee. The Board also welcomed Joan Parrott-Fonseca as the Mayoral appointee selected to complete the unexpired term of former Chairman Thomas Murray. Ms. Parrott-Fonseca has a wealth of experience in local, state and Federal Government which is further enhanced by substantive experience in the private and non-profit sectors with emphasis on business and economic development, municipal investment banking and international trade.

A special thanks goes to Council appointee Betty Ann Kane who resigned from the Board effective June 14, 2002. During her eight and a half years tenure on the Board, she served three terms as Chairman during a transition phase as the Board worked closely with the U.S. Treasury to accomplish the legislatively mandated transfer of assets and certain unfunded liabilities of the District's defined benefit retirement programs to the Federal government.

Jorge Morales, the Board's current executive director, and the first employee hired when the Board was officially established in 1979, announced his retirement effective February 2003. Mr. Morales has agreed to serve until the newly selected executive director takes office. The Board has interviewed several qualified candidates and expects to introduce its new executive director in the near future.

Finally, please be assured that in times of great optimism, and in times of uncertainty in the financial markets, the Board will continue to meet its fiduciary responsibility to prudently manage the assets of your retirement Funds.

Investment Program Update

Market Summary

Like the forest fires burning out of control in the western United States, new reports of corporate misgovernance have sparked demands for reform. Enron, Arthur Andersen, Tyco International, Global Crossing, WorldCom, Adelphia, ImClone, Dynergy, Computer Associates, Lucent, Qwest Communications, Reliant Resources and Xerox have all come under fire for questionable accounting and business practices. Cooked books, conflicted analysts, compromised auditors, and unscrupulous CEOs have shattered investor confidence and have left equity markets in a free fall. Primarily through exposure to the Retirement Board's index fund manager, the Retirement Board's investment portfolio incurred some losses from investments held in several of these companies. An index fund holds all the securities that make up its target index. Unlike actively managed funds, index (or "passively managed") funds do not buy and sell securities based on research and analysis. Rather, index funds simply attempt to mirror what the target index does, for better or worse.

Long before investor confidence started waning, the Retirement Board put in place policies and procedures to ensure that claims for recovery of losses are filed timely on our behalf by the Retirement Board's master custodian, State Street Bank and Trust Company. And, earlier this year, the Retirement Board retained two expert securities litigation law firms to assist the Retirement Board with tracking and collecting all monies due the Retirement Board from companies who violate Federal securities laws.

Dismal corporate earnings outlook, Middle East instability and lack of confidence in the markets caused the Dow Jones Industrial Average (a price-weighted average of 30 actively traded blue chip stocks) to drop almost 700 points in June 2002, with 40% of the trading days in the month losing more than 100 points. The Nasdaq Composite (national system for stocks traded "over-the-counter") continued to relinquish ground gained over the past five years, as it burned off more than 9% of its value in June. During the six months ending June 30, 2002, the S&P 500 Index (which measures changes in stock market conditions based on the average performance of 500 widely held common stocks) had lost 13%, while the Nasdaq Composite had dropped over 25% of its value. The major U.S. benchmarks for mid-cap and small-cap stocks, as well as value and growth stocks, were all charred with losses ranging from 2% to 8% in June alone. For the quarter also ending June 30, 2002, domestic equity returns ranged from -2% (small cap value stocks) to -21% (Nasdaq). And, the developed international equity markets, as measured by the MSCI EAFE Index, declined 8% in June in U.S. dollars, thereby dragging its year-to-date return to -10%. The MSCI EAFE Index was down 1.9% for the quarter ending June 30, 2002 as well.

The Federal Reserve Board, which lowered its target for short-term interest rates 11 times in 2001 to spur the economy, kept that target at 1.75% during the first half of 2002. For fixed-income securities, the second quarter of 2002 was also characterized by those events which adversely affected the equity markets. With no clear signs of an acceleration in the economy and the return of U.S. budget deficits, the Lehman Aggregate returned only 3.7% for the quarter ending June 30, 2002. What's an institutional investor expected to do? In this time of negativism, a focus on the long-term is crucial. Many public pension funds have turned to alternative investing (i.e., private equity, hedge funds, gold and timber to name a few) in search of additional returns.

Private equity investing enables an investor to participate outside the traditional markets in opportunities like venture capital (financing new businesses), buyouts (re-financing existing businesses), and other instruments. In the private equity world, there is less information published and fewer players than in the traditional markets; hence inefficiencies. Inefficiencies create the opportunities to generate excess return. Of course, greater risk accompany these potentially higher returns. In addition, private equity is also much more illiquid than publicly traded investments.

Nobody knows what will perform best next year, or for that matter, over the next decade. The Retirement Board continues to support the use of diversifying asset classes to augment returns and to reduce risk. For more diversification and enhanced returns, at the end of calendar year 2001, the Retirement Board committed $15 million of capital each to two private equity partnerships - Warburg Pincus Private Equity Fund VIII (special situation fund) and Blackstone Capital Partners IV (buyout fund).

Investment Performance Report

The District of Columbia Retirement Board's investment program returned -4.6% for the quarter ending June 30, 2002, outperforming the return earned by the Total Fund Benchmark (weighted index return of the Retirement Board's strategic asset allocation) of -5.3%. Despite significant losses within the domestic equity markets, the Retirement Board's domestic equity program outperformed the Russell 3000 (index of domestic large, mid and small cap stocks) by 110 basis points (or 1.1%), returning -12.0% for the domestic equity program versus -13.1% for the Russell 3000 index. Both the Retirement Board's international equity and fixed income programs detracted from performance results this quarter. The international equity program underperformed the MSCI EAFE Index by 0.4%, returning -2.3% versus the benchmark return of -1.9% for the quarter ended June 30, 2002. And, the fixed-income program returned 3.2% for the quarter, slightly underperforming the Lehman Aggregate Index return of 3.7%. Investment performance is calculated using time-weighted rates of return in compliance with AIMR (Association for Investment Management and Research) Performance Presentation Standards. Total returns for 3, 5, and 10 year periods ended June 30, 2002, were 0.3%, 5.6%, and 9.6%, respectively. Total return includes interest and dividends as well as capital appreciation.

Through this particularly difficult period, the fair market value of the Retirement Board's assets increased slightly (0.2%) from $2,003,603,406 on June 30, 2001, to $2,008,264,220 on June 30, 2002, due to employer and employee contributions.

A fundamentally disciplined philosophy and strategic asset allocation plan coupled with risk management techniques are the most effective means of delivering consistent, long-term performance in these volatile times. Remember, the investment objective of your investment program remains unchanged.

Legislative Report

The following update provides summary information on issues that affect the retirement plans for the District's Police Officers, Fire Fighters, and Teachers.

Council of the District of Columbia

The Council has approved amendments to the Teachers Retirement Plan and the Police and Firefighters Retirement Disability Act to permit adoption of portability provisions under the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA"). These amendments, incorporated under the "Fiscal Year 2003 Budget Support Act of 2002", permit individuals to transfer or rollover distributions from one type of retirement plan to purchase service credit in another retirement plan. Another provision under EGTRRA that raises the limit on compensation used for determining contributions and benefits was also approved by the Council. Please consult your personnel office for further detail.

In separate action, the Council approved a measure that requires an actuary (retained to estimate the financial effects over a 5-year period of a proposed change in benefit) to provide a financial impact study on both covered employee groups under the police officers and fire fighters retirement plan, when a change in benefits is proposed.

Longevity Update

As previously reported, legislation providing service longevity pay for police officers who complete at least 25 years of active service prior to retirement has not yet been implemented due to technical matters regarding benefit calculations, and certain other interpretive differences between the District and the Federal governments regarding "active service". With respect to the methodology used to calculate benefits, the Council has approved the required legislation, and a similar provision is expected to be considered by Congress as part of an appropriations bill in the near future. With respect to the interpretive differences, a bill has been drafted and is expected to be introduced in the Council to reconcile those differences. More information will be provided when available.

Pension Income Exclusion from District Taxation

Council member Vincent Orange, Sr. has introduced a bill (Bill 14-638) entitled the "Pension or Other Retirement Income Exclusion from Income Tax Amendment Act of 2002". This measure would increase the amount of pension income excludable from computation of income subject to taxation by the District of Columbia. The bill has been referred to the Committee on Finance and Revenue for further action.

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